TAB A

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Re: FCC Intercarrier Compensation -	:	
Workshop and Solicitation of Comments	:	**Docket No. M-00061972**
On the Missoula Plan	:	

COMMENTS
OF THE
PENNSYLVANIA OFFICE OF CONSUMER ADVOCATE

I. INTRODUCTION

On July 18, 2006, a coalition of telecommunications carriers under the auspices of the National Association of Regulatory Utility Commissioners Task Force on Intercarrier Compensation submitted the Missoula Intercarrier Compensation Reform Plan (the Plan) to the Federal Communications Commission (FCC). The FCC has solicited comments and reply comments on the Plan in the context of its Intercarrier Compensation proceeding.[1] The Plan seeks to unify intercarrier charges for the majority of lines and move all intercarrier rates charged for all traffic closer together.[2] The Plan also contains provisions that affect matters that are under the jurisdiction of the Pennsylvania Public Utility Commission (Commission), such as the setting of intrastate carrier access charges.

By Order entered August 23, 2006, the Commission determined that it should take an active role in formulating and submitting its own substantive comments and reply comments.[3] As part of that proactive response, the Commission concluded that the solicitation of detailed input from interested members of the public is appropriate. The Commission noted "a

[1] FCC CC Docket No. 01-92, DA 06-1510, 71 Fed. Reg. 45,510 (Aug. 9, 2006).
[2] 71 Fed. Reg. 45,511.
[3] In the Matter of FCC Intercarrier Compensation Proceedings at FCC in CC Docket No. 01-92, Docket No. M-00061972, Order (entered August 23, 2006)(Order).

significant part of this input solicitation is the organization of an appropriate workshop and facilitated discussion from interested participants on the Missoula Plan."[4] As a result, the Commission scheduled a public workshop and facilitated discussion for Monday September 11, 2006, with written materials submitted to the Commission no later than September 5, 2006.

In response to the Commission's solicitation for public input, the Office of Consumer Advocate (OCA) submits as follows:

II. COMMENTS

A. Introduction.

The stated purpose of the Missoula Plan is to unify rates paid by one carrier to another for the origination and termination of traffic. The rates, known collectively as intercarrier compensation charges, include interstate toll access charges, intrastate toll access charges, reciprocal compensation and payments for ISP-bound traffic. Currently, the nationwide rates for terminating an interstate toll call differ from the rates for terminating state toll calls and both of these rates differ from the reciprocal compensation rates. While the Plan accomplishes the immediate task of rate unification, it includes many other features that have substantial impacts on Pennsylvania carriers and consumers.

First, the Plan mandates a massive re-balancing of rates, reducing traffic sensitive (TS) intercarrier compensation rates and increasing non-traffic sensitive (NTS) rates borne by consumers, such as the Subscriber Line Charge (SLC). Second, the Plan pre-empts state ratemaking authority with regard to state access and intercarrier compensation rates. Third, the Plan establishes new universal service funding mechanisms and changes existing mechanisms. Fourth, the Plan contains other provisions that will benefit various local carriers in other ways.

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[4] Id. at 2.

The Comments of the OCA will explain the impact of these additional features on Pennsylvania carriers and consumers. In that process, OCA will highlight many of the ambiguous statements in the Plan and recommend that the Commission seek clarification of those issues in Comments to the FCC.

It is also necessary to explain that the Plan is not just one plan for all carriers. Rather, it is a combination of three plans, with a separate plan for each of three groups of carriers. The three groups of carriers are known as Track One, Track Two and Track Three carriers. Track One carriers include all Bell Operating companies and affiliates along with other large price cap carriers. In Pennsylvania, Verizon (Verizon-Pennsylvania and Verizon-North) is the only Track One carrier. Track Two carriers include many mid-size carriers. In Pennsylvania, Windstream (formerly known as Alltel), Embarq (formerly Sprint-United) and the Frontier study areas are Track Two carriers. All other Pennsylvania carriers are Track Three carriers.

Our analysis of the Plan suggests that the Commission should be concerned about many of the proposals included in the Plan. These proposals include:

- The substantial increase in Residential Subscriber Line Charges
- The 32 percent increase in the federal universal fund
- The 32 percent increase in the Pennsylvania contribution to the federal universal fund
- The creation of a subsidy from low-volume users to high-volume users of telephone services
- The establishment of intercarrier compensation rates that are below the incremental cost of service
- The protection of current levels of incumbent carrier revenues by end-users and other telecommunications carriers
- The exclusion of Track One carriers' reciprocal compensation savings from the revenue neutral calculation

- The risk of excessively high and constantly increasing Residential Subscriber Line Charges
- The ability of carriers to shift the cost of the Plan on to residential customers and away from multi-line business customers
- The ability of carriers to shift the cost of the Plan on to rural customers and away from urban customers
- The mandatory requirements to change state access rates
- The penalties associated with a decision by the Commission to opt out of the plan
- The lack of confidence regarding every number or support estimate included in the plan due to the failure of the Plan's sponsors to release the back-up data and spreadsheets that were used to calculate those estimates
- The speculative nature of the benefits of the Early Adopter Fund to Pennsylvania carriers and consumers
- The inclusion of extraneous high cost fund adjustments and regulatory incentive plans
- The lack of assurances regarding any requirements for carriers to flow through access savings to end-users

The OCA will address each of these issues below.

B. Interstate Carrier Access Charges.

The proposed changes in Interstate access charges vary according to carrier track. There will be significant reductions for Track One and Track Two carriers, while Track Three rates will remain at current levels. To understand the implications of these changes, it is necessary to examine each Track separately.

1. Track One Carriers.

Terminating interstate access charges will decrease from an average of 0.55 cents to 0.05 cents per minute over a four-year period. This is a 91 percent decrease. The originating rate will be capped at 0.2 cents per minute for end-office switching. Carriers are allowed to maintain rates for tandem-switched transport at 0.25 cents and dedicated transport rates at current levels.

The originating rates are only caps. A carrier may choose to reduce originating rates below the caps.

Carriers will be allowed to increase the SLC to offset the revenue loss associated with the reduction in access charges. If the SLC increases are not sufficient to make-up for the revenue loss then a carrier may receive additional funding from a new funding mechanism called the Restructure Mechanisms. The details of the SLC increases are discussed in this section of the comments, while the Restructure Mechanism will be discussed below in the section on the federal universal service fund.

a. Subsidies

Discussions of interstate access charges have long focused on an alleged subsidy flow from high-volume customers to low-volume customers. The per-minute interstate carrier common line charge (CCLC) was the alleged cause of this subsidy.[5] Customers paid for their interstate loop costs directly through their SLC payments and indirectly through the CCLC. High-volume customers generated more CCLC revenue than low-volume customers and, therefore, it has been asserted that the CCLC was an implicit subsidy.[6] To undue the subsidy, the FCC has taken many actions to reduce the CCLC and increase the SLC. These actions culminated with the CALLS and MAG Orders.[7] In these Orders, the FCC substantially increased the SLC and virtually eliminated the CCLC. In adopting the MAG Order, the FCC stated:

> The Commission [the FCC] has long recognized that, to the extent possible, interstate access costs should be recovered in the manner in which they are incurred. In particular, non-traffic sensitive costs –

[5] The National Association of State Utility Consumer Advocates, of which the OCA is a member, has shown that many residential SLCs are greater than the incremental cost of service. Therefore, the evidence supporting a subsidy claim does not exist for most residential customers. *See*, NASUCA comments in the SLC costing docket.

[6] In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, *Second Report and Order*, FCC 01-304, released November 8, 2001, (MAG Order),¶15.

[7] In the Matter Access Charge Reform, CC Docket No. 96-262, Sixth Report and Order, FCC 00-193, released May 31, 2000, (CALLS Order); *see also*, MAG Order.

> costs that do not vary with the amount of traffic carried over the facilities – should be recovered through fixed, flat charges, and traffic sensitive costs should be recovered through per-minute charges.[8]

The Missoula Plan, however, contradicts these assumptions and the reasoning used to justify rate changes because the plan proposes to recover traffic sensitive switching and transport costs through increases in the SLC, a flat charge. Instead of eliminating subsidies, the Plan creates a new subsidy from low-volume end-users to high-volume end-users by increasing fixed charges to recover traffic sensitive costs.

Moreover, even if the SLCs are not increased, the proposed terminating rate (0.05 cents per minute) is a subsidized rate because it is below the current reciprocal compensation rate (estimated to be approximately 0.2 cents per-minute). States approve reciprocal compensation rates based on a general outline and rules established by the FCC. These rules require the states to approve rates based on the FCC Total Element Long Run Incremental Cost (TELRIC) principles.[9] Thus, approved reciprocal compensation rates are equal to the incremental cost of services.[10] It is generally accepted that a rate below the incremental cost of service is a subsidized rate.[11] Therefore, because the Plan's proposed rate is below the incremental cost of service as measured by current reciprocal compensations rates, the rate is a subsidized rate.

b. Subscriber Line Charges.

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[8] MAG Order, at ¶17.
[9] 47 C.F.R. §51.705.
[10] ILECs have criticized state commissions for interpreting these rules in a manner that sets rates too low (below what they considered to be the incremental cost of service), but have not criticized state commissions for setting these rates too high. *See e.g.*, Declaration of Howard Shelanski submitted in support of the comments of the Verizon Telephone Companies, In the Matter of the Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers, WC Docket No. 03-173; Declaration of Paul B. Vasington, submitted on behalf of Verizon Maine, Investigation into Line Sharing Pursuant to State Law, Maine Public Utilities Commission Docket No. 2004-809.
[11] Faulhaber, Gerald, 1975, "Cross-Subsidization: Pricing in public enterprise," *American Economic Review*, 65, December, pp. 966-977.

The Plan allows carriers to recover lost revenue through increases in SLCs. However, there are many issues associated with the SLC increase that are unclear in the Plan. To understand these issues, it is necessary to define a number of terms and review how the Plan allows carriers to adjust SLCs over time. There is a need to clarify the difference between allowed SLC increases and allowed increases in SLC caps. For example, the current residential SLC cap is $6.50. Over a four-step process, this cap is allowed to increase to $10.00. However, simply because the Plan allows the SLC to be increased to $10.00 should not be seen as sufficient reason to increase every residential SLC to $10.00. In fact, the Plan establishes rules for SLC increases that are separate from the rules for SLC cap increases. It is, however, necessary to juxtapose the SLC increase rules and SLC cap increase rules in order to get a clear understanding of how the SLC can increase.

i. SLC caps

There are three types of SLC caps. The first type is a nationwide cap. As discussed above, the current cap is $6.50. The nationwide cap is allowed to increase to $10.00 during the first four steps of the plan and then increase with inflation in step 5 and succeeding years. The second cap restrains increases on individual SLCs. It allows for increases of 95 cents in the first two steps, $1.20 in steps 3 and 4 and then is no longer binding in step 5. The third cap is related to the average SLC within a defined market category. The Plan defines two market categories. There is a Mass-Market category that includes primary residential lines, non-primary residential lines and single-line business. The second category is the multi-line business market defined as the Enterprise Service category. Within each market category, a carrier can de-average rates. The third cap is associated with the de-averaging process. Table 1 below shows the impact of these caps on Verizon.

The current Verizon Pennsylvania residential SLC is constrained to no more than $5.90 because the line "cost" is less than the cap (the Verizon North residential SLC is $6.50). In step one, Verizon Pennsylvania's individual rate cap would increase to $6.85. Thus, even though the nationwide cap is $7.25, no individual customer can pay more than $6.85. The average rate cap affects rate de-averaging. If Verizon chooses to set rates for half its customers at the $6.85 cap, then the cap for the other half of its customers would be $6.45. On the other hand, if the Verizon chooses to retain study area average rates, then the highest rate cap for any residential customer would be the average rate of $6.65. In step 4, the nationwide rate cap is less than the individual rate cap. Thus, the nation wide rate is binding and no residential customer can have a rate cap higher than $10.00. Again, if Verizon divides the Mass Market into two equal sub-groups, the higher priced sub-group would be limited to a $10.00 rate cap and the lower priced sub-group would be limited to a $8.80 rate cap. Finally, if Verizon chooses to retain study area average rates, then the highest rate cap for any residential customer would be $9.40.

Table 1: Track One Res. SLC CAP			
	Verizon Pennsylvania Residential SLC Caps		
Steps	National Cap	Individual Rates	Average Rates
1	$7.25	$6.85	$6.65
2	$8.00	$7.80	$7.40
3	$9.00	$9.00	$8.40
4	$10.00	$10.20	$9.40
5	increases with inflation	no longer binding	no longer binding
	Verizon North Residential SLC Caps		
Steps	National Cap	Individual Rates	Average Rates
1	$7.25	$7.45	$7.25
2	$8.00	$8.40	$8.00
3	$9.00	$9.60	$9.00
4	$10.00	$10.80	$10.00
5	increases with inflation	no longer binding	no longer binding

In Step 5, however, the individual and average rate caps are eliminated, and the national cap is allowed to increase with inflation. These changes will allow the Residential SLC to increase forever, leading to an excessively high Residential SLC.

ii. Allowed SLC increases

The Plan appears to allow a maximum allowed SLC increase that can be less than or greater than the allowed increase in the caps. The maximum is a function of Access Shift Per Line, the number of lines served during the current period, and a time trend.

The Access Shift Per Line is defined as the Access Shift divided by the number of lines in the base period. The Access Shift is defined as the loss in revenue that the carrier expects to lose over the course of the plan. For example, if the carrier has 3,000,000 terminating minutes in the base period and the terminating charge decreases from 0.55 cents to 0.05 cents, then the revenue loss associated with terminating charges would be $15,000. If the carrier has 10,000 lines in the base period, then the Access Shift per line is $1.50.

The Plan lists the type of revenues that each carrier would include in its Access shift estimate. They include originating access, terminating access, dedicated transport, and extended area service (EAS) revenue. Conspicuously absent from the list is reciprocal compensation revenue. Given the normal assumption that large ILECs have a negative net reciprocal compensation revenue (that is more traffic flows from ILECs to CLECs than from CLECs to ILECs), the failure to include reciprocal compensation in the Access Shift calculation increases the Access Shift levels. Higher Access Shift estimates increase SLCs. The Track One ILECs will receive the benefit of both the increase in SLCs and the reduction in reciprocal compensation payments.

The time trend increases the percentage of the Access Shift per line that can be recovered in each step. The Access Shift is calculated as if the Plan's total rate reduction occurs instantaneously. It is based on the difference between the current rate and the step four rates. However, during steps 1 through 3, the rate reductions are lower than the final reduction. The time trend forces the percentage increases in revenue loss to match the percentage decreases in rates in the first three steps. In step four, following the completion of rate reduction, the recoverable revenue equals the Access Shift per line multiplied by the current lines. In each of the first three steps, the recoverable revenue equals the Access Shift per line multiplied by the appropriate time trend multiplied by the current lines.

The Plan appears to be revenue neutral only if the current year line count equals the base year line count. If lines decline, the carrier's revenue declines. If lines increase, the carrier's revenue increases. However, given that the reciprocal compensation revenue is not included in the Access Shift estimate, it is possible for the lines to decline and revenue to increase.

The Plan also does not specify what is the maximum recoverable revenue in step 5. It is unclear whether the Access Shift per line ever increases by any time trend after Step 4 or for any other reason. An explicit statement of this assumption by the FCC would be beneficial to clear up this ambiguity.

Another reason for requiring an explicit statement regarding this issue is that the Plan states: "Said another way, in the absence of deaveraging, a carrier's total recovery at a particular Step of the Plan – from SLC increases and the Restructure Mechanism – will equal the portion of Access Shift Per Line recoverable at that Step multiplied by the carrier's number of lines at that Step."[12] The phrase "in absence of deaveraging" requires further explanation. It is unclear

[12] The Plan, VI-A-1-b-vi.

whether the phrase implies that when a carrier deaverages its SLCs, it can recover in excess of an amount equal to the Access Shift Per Line multiplied by the number of lines.

iii. The Base-Year used to calculate the Access Shift

The Plan maintains a frozen base-year for the purposes of calculating the Access Shift. If the effective date of the Plan is July 1, 2007, the frozen base-year will be the calendar year beginning January 1, 2006. The effect of this freeze is to insulate the carriers from time trends associated with decreases in access minutes of use. This effect extends the regulatory impact from one that provides an alternative revenue source equal to the revenue reduction associated with a rate reduction ordered by the regulator to an impact that protects the carrier from market activity that has been reducing the applicable minutes of use. It is not appropriate to lock in and preserve any particular revenue levels in the face of future usage declines that are likely to occur.

Track One carriers benefit from this approach. The other telecom providers (through universal service contributions) and end-users (through SLC increases and universal service contributions) are required to support the carriers.

An alternative approach would be to allow the carrier to recover only the revenue reduction associated with the rate reduction that would take place in each year. The Access Shift in each step would be calculated as the difference between the base year rate and the current rate multiplied by the current year minutes. This is the proposal sponsored at the FCC by the National Association of State Utility Consumer Advocates (NASUCA) of which the OCA is a member.[13] Under this approach, SLC customers would not be responsible for the carriers' inability to maintain sales in access markets.

iv. The relationship between the Enterprise and Mass Market SLCs

[13] Comments of the National Association of State Utility Consumer Advocates, In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket no. 01-92, filed March 23, 2005, pages 12-14.

Currently, if the residential SLC is less than the residential SLC cap, the residential SLC and the multi-line business SLC are equal. For example, for Verizon Pennsylvania, both SLCs are $5.90. If the residential SLC equals the residential SLC cap, the multi-line SLC cap can be higher than the residential SLC but no higher than the multi-line business SLC cap of $9.20. For example, Verizon North has a residential SLC of $6.50 and a multi-line business SLC of $8.11.

The Plan states that SLC price reduction for one market cannot be offset by SLC price increases in the other market.[14] This constraint only places a limit on one type of price discrimination. In addition, the current FCC rules prohibit carriers from setting the multi-line business SLC lower than the residential SLC in a geographic market.[15] However, the Plan does not indicate if the current FCC rule will be maintained. Without the current rule, Verizon would be able to increase the residential SLCs and retain the current multi-line business SLC. Thus, the Plan does not prohibit carriers from increasing residential rates to recover Access Shift revenue associated with multi-line business customers.

The following example illustrates how carriers could require residential customers to pay for Access Shift revenue associated with multi-line business customers. Let a carrier have 800 residential customers and 200 multi-line business customers. Let the Access Shift per line be $1.20 in step 2. Therefore, the total revenue that can be recovered is $1,200. Also, assume that the residential SLC is $6.50 and the multi-line business SLC is $8.00. If every customer is equally responsible for the Access Shift, then the residential SLC increases to $7.70 and the multi-business SLC increases to $9.20. These increases are allowed because the new SLCs are equal to or less than the SLC caps. However, the carrier can also recover the $1,200 by increasing the residential SLC by $1.50 to $8.00 and retaining the current multi-line business

[14] The Plan, II-C-5-b.
[15] 47 C.F.R. §69.152(q)(3).

SLC at $8.00. These alternative SLCs will also be allowed because the alternative SLCs are equal to or less than the SLC caps.

An additional constraint is required to prevent carriers from increasing residential SLCs for the purpose of recovering Access Shift revenue associated with multi-line business customers. The additional constraint would be to set the allowed step 4 revenue recoverable from each market equal to the Access Shift per-line multiplied by the current period lines in that market.

v. Pricing Flexibility

Price cap carriers will be allowed to vary their prices in many ways. During the first three steps of the plan, there will be some constraints placed on the pricing flexibility. For example, each carrier will be limited to four pricing zones. However, most of these constraints will be removed in step 4.

During the first four steps, when a carrier de-averages, the carrier is limited to the extent that there are caps on individual SLC increases. After step four, this limitation is no longer binding. Moreover, there is nothing that prevents a carrier from reducing the SLC in one pricing zone and increasing the SLC in another zone as long no SLC exceeds the nationwide cap.

To illustrate this possibility, start with the current Verizon residential SLC of $5.90. Assume that the Access Shift per line is $2.00, and if there is no pricing flexibility the SLC would increase to $7.90. However, there is the possibility that the study area is divided into two zones with the same number of lines in each zone. In a rural area where there are few, if any, competitors, the carrier could increase the SLC to $10.00. In another zone, the carrier could reduce the SLC to $5.80. To prevent this type of price discrimination, it is necessary to add a provision that requires that the difference between the lowest residential SLC and the highest residential SLC be no greater than $2.50. Also, to prevent excessively high SLCs in any zone, the provision to allow the SLC to be adjused by inflation so that the cap will be greater than $10 in Step 5 and beyond should be eliminated.

There are also some unusual statements in the pricing flexibility section of the Plan that require further explanation. For example, the SLC revenues generated by contract tariffs are not included in the price-cap basket.[16] There is no explanation for why this item is included in the Plan. Moreover, the Plan does not explain whether or how removing a SLC from the price cap baskets may affect the calculation of allowed SLCs for all remaining customers. The Plan also allows carriers to sell bundles where the bundled price includes all or part of the SLC.[17] This possibility will make it very difficult for regulators to verify if the carriers are charging the allowed SLCs and recovering only the allowed revenue and revenue increases.

2. Track Two Carriers.

The important differences between Track One and Two carriers include:

- Final transport and tandem switching rate caps are higher for Track Two carriers. Track Two end-office switching rates will match the Track One rate of 0.05 cents. Because Track Two carriers' current rates are probably higher than current Track One carrier rates, the revenue loss associated with the rate re-balancing on a per-line basis will likely be higher for Track Two carriers than for Track One Carriers.

- Residential SLC caps increase only to $8.75 for Track Two carriers, and the multi-line business cap increases to $10.00. There is no inflation adjustment to the caps in step 5. The lower SLC cap will allow Track Two carriers to draw from the Restructure Mechanism earlier than Track One carriers. On the other hand, because Track Two carriers are more likely to begin the process with Residential and Multi-business SLCs at their current $6.50 and $9.20 caps, a Track Two carrier's revenue recovery will start with increases in the Residential SLC from $6.50 to $8.75.

[16] The Plan, II-C-7-a-v-1.
[17] The Plan, II-C-7-a-vi-1.

- Rate-of-return Track Two carriers are not allowed to use the new pricing flexibility rules.

3. Track Three Carriers.

The current interstate access rates are the final access interstate rates. If the Plan is adopted by the state commission, the final intrastate access rates will equal the current interstate rates. The current interstate rates will serve as the default rates for reciprocal compensation traffic, unless there is an existing lower state approved reciprocal compensation rate or a lower rate in a carrier-to-carrier agreement. Wireless carriers that do not have existing agreements with Track Three carriers will be charged the interstate access terminating rates for terminating a call with a Track Three carriers. This policy may increase Track Three carrier revenue.

Residential SLC caps increase only to \$8.75, and the multi-line business cap increases to \$9.20. There is no inflation adjustment to the caps in step 5. The lower SLC cap will allow Track Three carriers to draw from the Restructure Mechanism earlier than Track One and Track Two carriers. On the other hand, because Track Three carriers are more likely to begin the process with Residential and Multi-business SLCs at their current \$6.50 and \$9.20 caps, Track Two revenue recovery will start with increases in the Residential SLC from \$6.50 to \$8.75.

All Rate-of-Return carriers will recover their current revenues. Any shortfall in the revenues will be recovered through the Restructure Mechanism. The specific details of the measurement are complicated by the choice of a base year for interstate revenue and the current calendar year for state revenue. The calculation of the shortfall also assumes that carriers increase their SLCs to the SLC caps. The calculation includes revenue from the local switching support mechanism but excludes revenue from the high cost loop mechanism.

C. Intrastate Rates.

1. Mandatory Or Voluntary Changes.

The Plan mandates certain changes in intrastate access terminating rates for Track One and Track Two carriers. This compromise of state ratemaking authority will take place whether or not the state decides to accept the Missoula Plan. States may also choose not to accept state authority over intrastate access originating rates for Track One and Track Two carriers and to maintain authority over both originating and terminating state access rates for Track Three carriers. However, even if the state retains authority over intrastate originating access for Track One and Track Two carriers, the SLC caps will increase according to the Plan's schedule. Thus, a state can maintain higher state originating access charges, but SLC rates will increase in the state as if the state had decided to reduce intrastate originating access revenue, even though such carriers will not realize such reduced intrastate access revenue. For Track Three carriers, if the state retains authority over intrastate access rates, then the SLC caps will not increase.

2. Penalties For Not Adopting The Plan.

If a state wishes to retain its authority over any state access rates, then all carriers in that state are not allowed to draw from the Restructure Mechanism and the state will not be allowed to shift its state universal funding requirement to the Early Adopter Fund. These penalties can be very severe and, therefore, there is little expectation that a state would opt out of the Plan. For Pennsylvania, the penalty could exceed $100 million because, as explained below, Pennsylvania could receive approximately $33 million from the Early Adopter Fund, and Pennsylvania carriers could receive approximately $69 million from the Restructure Mechanism.

3. Size Of The State Rate Reduction.

In each Track, the intrastate access rate will equal the interstate access rate. Therefore, in Tracks One and Two, the intrastate end-office terminating rate will ultimately equal 0.05 cents. For Track Three, the intrastate rates will equal the current interstate rates.

D. Federal Universal Service Fund Contributions And Support Payments.

1. The Increase In The Federal Universal Service Fund.

The Plan proposes to increase the federal universal service fund by $2.25 billion. This increase includes $1.5 billion for the Restructure Mechanism, $200 million for the Early Adopter Plan, $225 million for Lifeline Increases, and $300 million for high cost loop adjustments.

These increases are substantial. The federal universal service fund would grow by 32 percent, high-cost funding would grow by 48 percent and lifeline funding by 27 percent.[18] The federal contribution factor would increase to 13.8 percent from its current 10.5 percent.

The Plan does not formally include the Restructure Mechanism as part of the universal service fund even though the Mechanism is, in practice, part of the fund. This formality may be an attempt to exempt the Mechanism from the FCC's portability rules. The basic principle of those rules is that a CLEC serving a customer in an ILEC territory receives the same support as the ILEC. Thus, if the Restructure Mechanism is not part of the federal universal service fund, a CLEC cannot receive Restructure Mechanism support.

There are also two estimates of the size of the Restructure Mechanism. The first is $1.3 billion and the second is $1.5 billion.[19] This $200 million difference is significant. The sponsors of the Plan should provide the back-up data and spreadsheets that generated these estimates so that state commissions, the FCC, and independent parties can verify the estimates. Individual

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[18] The percentage increases are calculated as increases from third 2006 projected industry requirements. *See*, Proposed Third Quarter 2006 Universal Service Contribution Factor, CC Docket No. 96-45, DA06-1252, released June 9, 2006.

[19] The Plan, Appendix D; *See*, August 17, 2006 Letter from The Missoula Plan Supporters to Ms. Marlene Dortch, Secretary, FCC, In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92.

carriers should provide the state commissions and the FCC with their best estimates of the amount of Restructure Mechanism they would receive under the Plan so that the state commissions and the FCC will have an alternative estimate of the Plan's funding requirements.

With regard to the high cost fund adjustment, it is possible to use public data to verify the Plan's $300 million estimate. The data are included in the annual NECA filing to the FCC.[20] It is possible to calculate the high cost fund adjustment by comparing the support generated by existing rules to the support generated by the proposed rules. The difference between the two support estimates is $350 million, not the Plan's reported $300. This difference between the Plan's estimate and our independent estimate raises questions regarding the estimates provided in the Plan. The only way to verify the Plan's estimates is for the sponsors of the Plan to release all of their data and back-up spreadsheets. Such a release will allow all of the estimates to be verified including not only the summary national estimates but also state and carrier estimates.

In addition, there is no connection between the proposed purpose of the Plan, reducing arbitrage opportunities with regard to intercarrier terminating traffic, and the high cost fund adjustment. The Plan also contains a so-called "incentive regulation plan" for rural carriers. The "incentive regulation plan" will allow carriers to increase their receipt of high cost funding based on an inflation adjustment rather than on their costs.[21] Accordingly, the incentive plan provides a carrier an incentive to do nothing and collect more support. It is clearly inferior to the current high cost support mechanism that contains an incentive to invest in new equipment and facilities. The cost of the so-called "incentive regulation plan" has not been included in the total support payments required by the Plan.

2. The Pennsylvania Contribution To The Federal Fund.

[20] Universal Service Fund Data: NECA Study Results, http://www.fcc.gov/wcb/iatd/neca.html.
[21] The Plan, VII.

Currently, Pennsylvania is responsible for 4.2 percent of the federal universal service fund. The 4.2 percent estimate is an estimate of the percent of the federal universal service fund revenue base that is associated with Pennsylvania carriers and end-users.[22]

The Plan suggests that the support should be based on telephone numbers rather then on the current revenue. A change from revenue to numbers will probably not have an impact on the size of the Pennsylvania contribution because 4.2 percent of all numbers are assigned to Pennsylvania area codes.[23] Therefore, the Pennsylvania contribution to the federal universal service fund is likely to increase by 32 percent, the percentage change in funding contained in the Plan, no matter what type of contribution mechanism the FCC adopts to fund the Plan.

3. Federal Support To Pennsylvania.

a. The Early Adopter Fund

The Plan establishes an Early Adopter Fund to reimburse states that have already reduced state access charges. As proposed, the Early Adopter Fund reimburses states only for explicit universal service funding that can be tracked to specific access rate reductions. It does not reimburse states that have used local rate increases to offset access rate reductions. The Plan intimates that there are ongoing discussions regarding compensation for access rebalancing related to local rate increases.[24] Many states have chosen to use local rate increases to offset access reductions for large Bell Operating Companies. If the Early Adopter Fund were to cover those re-balancing efforts, then the fund size would grow by a very large amount. However, to date, the Plan does not contain a recommendation on this issue.

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[22] December 2005 Monitoring Report, http://www.fcc.gov/wcb/iatd/monitor.html, Table 1.12-continued.
[23] Craig Stroup and John Vu, "Numbering Resources Utilization in the United States as of June 30, 2005" Industry Analysis and Technology Division, FCC, released May 2006, Table 4.
[24] The Plan, footnote 27.

Accordingly, Pennsylvania would be able to transfer its $33.5 million state fund to the Early Adopter Fund, if the FCC adopts this part of the Plan and the Early Adopter Fund is large enough to fund completely all state universal service funds. The Pennsylvania local rate increases that offset access rate reductions would remain the responsibility of the local customer unless the mechanisms compensated by the Early Adopter Fund are redefined and expanded.

The Plan estimates that the Early Adopter Fund will be $200 million. However, the Plan Sponsors have not released the data sources relied on to generate this estimate. OCA has not calculated the sum of all state universal service funds. If the total amount necessary to compensate for all state universal service funds becomes very large, the FCC may be reluctant to fund the states on a dollar for dollar basis and some proportionate funding may be required. In that case, Pennsylvania may be forced to retain part of the current state fund.

b. The Restructure Mechanism

The Restructure Mechanism makes up the difference between the allowed revenue recovery and the revenue increases that would have occurred if the carriers increase their SLCs to the SLC caps. The Plan estimates that funding through the Restructure Mechanism will be $1.3 to $1.5 billion. This total includes $320 million for Track One carriers, $548 million for Track Two carriers, and $458 million for Track Three carriers.[25] On a per-line basis, Track One carriers receive $2.19, Track Two carriers receive $43.84, and Track Three carries receive $62.74 per year.

The Plan did not release any data supporting its calculation of Restructure Mechanism on a national, state or carrier basis. Thus, it is not possible to verify the Plan's estimates or directly determine a Pennsylvania estimate.

[25] The Plan, Appendix D, page 100.

It is possible to determine a preliminary estimate of the funding for Rural Pennsylvania carriers using data obtained in Pennsylvania Docket No. I-00040105 (the rural access docket).[26] The filed data provide the number of residential lines, number of total lines and the common line rate by carrier for 2004. Assuming that, under the Plan, the common line charge will be eliminated, the total revenue loss is calculated as the total lines multiplied by the common line rate. The SLC increase is the difference between current SLCs and the proposed SLC cap multiplied by the number of residential lines. For Track Two carriers, under the assumption that all business customers are multi-line business customers, the business SLC revenue increases by the difference between the current SLCs and the proposed SLC cap multiplied by the difference between number of total lines and the number of residential lines.[27] The result of this preliminary calculation is that Pennsylvania receives $69.3 million from the Restructure Mechanism, if Pennsylvania chooses to participate.

c. The High Cost Fund Adjustment

The Plan endorses two adjustments to the high cost fund. First, the Plan removes the index fund cap and allows the fund to be recomputed as if the fund cap did not exist. This is a one time upward adjustment. Later the fund cap is activated again. Second, the support rules for carriers with more than 200,000 lines are changed such that they match the support rules for carriers with less than 200,000. This rule change is permanent.

A carrier receives high cost fund support based on the difference between its study area cost and the national average cost. A carrier's study area cost is determined from its books and

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[26] Because the data were filed under a confidential agreement, only a statewide roll-up estimate will be provided in this comment.

[27] The current multi-line business cap is $9.20 and proposed cap is $10.00. The difference between total lines and residential lines is the number of business lines. However, the business line count would include both single and multi-line business lines.

records based on an FCC approved 26-step algorithm.[28] The national average cost can be calculated several ways. First, it can be calculated as the line-weighted average of all the individual study area costs. Second, when the total support calculated using the line-weighted national average is greater than the fund cap, the national average used for the purposes of determining carrier support is adjusted upward so that total support equals the fund cap.[29] For support in 2006, the national line-weighted average is $275, while the national average used to determine support is $318.[30]

Removing the fund cap allows a carrier to receive support based on the $275 average rather than based on the $318 average. The additional support for any carrier is the difference between the support between the support calculated using the $275 average and the support calculated using the $318 average. For all Pennsylvania carriers, the combined increase in high cost support is $2.2 million. This additional funding is excluded from the calculation used to determine Restructure Mechanism funding.

E. Pennsylvania USF Contribution And Support Payments.

The Pennsylvania Universal Service Fund was established to replace revenue reductions associated with state access rate reduction.[31] As such, the Pennsylvania state fund qualifies to be supported by the Early Adopter Fund. Therefore, the state fund payments should transfer into the Early Adopter Fund and the state fund contribution would be eliminated. However, as noted above, because of the Plan's under-estimation of total support payments and because of the magnitude of the Plan's proposed fund increase, the FCC may be reluctant to completely replace state funding with federal funding. Therefore, we anticipate that the state will be left with a state

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[28] 47 C.F.R.§36.621.
[29] 47 C.F.R.§36.622 .
[30] NECA's Overview of Universal Service Fund, http://www.fcc.gov/wcb/iatd/neca.html, filed September 30, 2005.
[31] Re: Nextlink Pennsylvania, Inc., 93 PA PUC 172 (Sept. 30, 1999); *see also*, Re: Establishing Universal Service Fund Regulations at 52 Pa. Code §§ 63.141-63.151, Docket No. L-00000148, Order (entered Jan. 27, 2000).

universal service funding responsibility even though the Plan proposes to eliminate that requirement.

F. Other Issues.

1. Flow Through Of Rate Reductions.

The Plan requires significant reduction in many rates. However, there is no requirement for carriers that pay those lower rates to pass the rate reduction through to their retail customers. The Plan anticipates that competition will force carriers to pass through the savings. However, there are no sufficient assurances that consumers will realize any rate reductions. In the alternative, the FCC could require the savings to pass through to retail customers. In either case, the carriers should ensure that the retail customers receive the savings as a result of any access reductions. This Commission must consider the extent to which any past access reductions has in fact resulted in a public benefit in the form of lower rates for consumers before it endorses or encourages the adoption of any plan regarding access reductions.

2. Accounting For Contract Lines.

Many carriers are serving customers under individual contracts rather then under tariff. The Plan on several occasions mentions this activity. However, it is not clear how the Plan uses contract lines in all of its various calculations. For example, it is unclear whether contract lines are included in the line count used to determine the Access Shift Per Line value. We recommend that the Plan clarify how it counts contract lines in each of its calculations.

3. Local Benchmark.

The Plan speculates that a mechanism may be developed that would increase the Track Three carrier SLCs above the $8.75 constraint. This additional mechanism is based on the relationship between the carrier's local rate and a local rate benchmark. If the local rate is below the benchmark, then it would be possible to have larger SLCs increases than permitted under the general constraint.[32]

For all practical purposes this mechanism would allow the FCC to set local rates. This is clearly an unreasonable preemption of state ratemaking authority and should not be allowed. In addition, there is no discussion in the Plan regarding the level of the local benchmark or how it could be established. Therefore, it is not possible to determine the impact of this mechanism.

III. CONCLUSION

WHEREFORE, the Pennsylvania Office of Consumer Advocate respectfully submits that this Commission consider these Comments as part of its public workshop and facilitated discussion regarding the Missoula Plan recently submitted to the Federal Communications Commission.

Respectfully submitted,

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[32] The Plan, II-C-1-b-vi.